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Supreme Court, U.S.
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No. _____

In The
Supreme Court of The United States
October Term 1996

PSI REPAIR SERVICES, INCORPORATED,
Petitioner,

v.

HONEYWELL, INCORPORATED,
a foreign corporation,
Respondent.

Petition For A Writ Of Certiorari
To The United States Court of
Appeals For The Sixth Circuit

PETITIONER'S REPLY BRIEF

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REPLY BRIEF FOR THE PETITIONER

Honeywell predictably has presented a number of arguments to bolster the Sixth Circuit's decision in *PSI Repair Services, Inc. v. Honeywell*, 104 F.3d 811 (6th Cir. 1997). Most of these arguments involve factual disputes, highlighting the improper resolution of these issues by the Sixth Circuit. Honeywell, however, has correctly identified the central underpinning to this decision. In its Brief in Opposition to the Petition, Honeywell claims this Court requires a "change in policy" as a prima facie "element" to a *Kodak* case. [Br. in Opp. 8]. Now, according to Honeywell and the Sixth Circuit, the law of tying and monopolization will turn on a "change in policy" requirement gleaned from this Court's footnote in *Eastman Kodak Co. v. Image Technical Service, Inc.*, 504 U.S. 451, 477, n.24 (1992). It is the absence of this "element" that caused the Sixth Circuit to conclude as a matter of law that no market power could exist in the aftermarket. But for this distinction, PSI would mirror *Kodak*. Because this distinction does not deserve the legal import Honeywell and the Sixth Circuit would impose, PSI respectfully submits that this case is worthy of the Court's intervention.

In truth, a change in policy has limited factual significance to the economic analysis of *Kodak*. Such a change merely illustrates the difficulty of lifecycle pricing. In *Kodak*, consumers had purchased their equipment anticipating the availability of third party service. When Kodak altered its parts policy, it could take advantage of

"locked-in" customers to reap monopoly profits in service without necessarily endangering sales in equipment. Kodak's customers, like most other customers of durable goods, could not determine the total costs of ownership because of the many factors involved in this exhausting calculation. See *Kodak*, 504 U.S. at 473-474 ("Much of this information is difficult -- some of it impossible -- to acquire at the time of purchase.") Hence, it was not economically senseless to believe that a manufacturer could play upon its customers' inability to gauge the cost of an anticompetitive policy.

However, the difficulty of lifecycle pricing can exist irrespective of a change in policy. The Sixth Circuit, in fact, noted the presence of this forecasting hurdle in this case. See *PSI Repair Services, Inc. v. Honeywell*, 104 F.3d 811, 819 (6th Cir. 1997)("[PSI]" points to deposition testimony by Honeywell's own personnel that it would be "very difficult" for customers to determine the life-cycle cost of its equipment.") The Court of Appeals, unfortunately, failed to accord this evidence any economic significance. *PSI Repair Services*, 104 F.3d at 820.

Indeed, in light of the difficulty of lifecycle pricing, it was not economically senseless for a manufacturer like Honeywell to take advantage of this less than responsive connection between the equipment market and the aftermarket. In fact, Honeywell did. As in *Kodak*, Honeywell secured its control over unique parts through restrictive agreements with its parts manufacturers. It then

used this power over parts to its advantage, foreclosing competition, charging supracompetitive prices, and forcing the unwilling consumption of Honeywell's service. (C.A.App. 1047-1048). As evidence of the level of its control over parts, Honeywell, like *Kodak*, even price-discriminated among its customers by selling components to large self-maintainers but refusing to sell them to others. See *PSI Repair Services*, 104 F.3d. at 816 ("Indeed, Honeywell itself sells components for its PLC equipment to customers and admits allowing one customer to purchase TDC components from it."); see also *Kodak*, 504 U.S. at 476. Hence, Honeywell can and has taken advantage of the lack of knowledge in the equipment market.

The central fallacy behind the Sixth Circuit's opinion in this case is that the wrong in *Kodak* was the change in policy. In fact, the anticompetitive conduct in *Kodak* is identical to the conduct in this case - the use of control over unique parts to charge supracompetitive prices and foreclose competition in a separate market. *Kodak*, 504 U.S. at 478, 479, n. 29. As stated by this Court,

> The alleged conduct -- higher service prices and market foreclosure -- is facially anticompetitive and exactly the harm that antitrust laws aim to prevent.

Kodak, 504 U.S. at 478. Contrary to Honeywell, *Kodak* did not take a great leap forward in antitrust analysis by requiring an additional anticompetitive "element" to a claim of tying and monopolization. [Br. in Opp. 8].

In the face of conduct aimed at eliminating competition at its inception, Honeywell took on the garb of an innocent monopolist, claiming it had done nothing more than inherit a parts monopoly. In fact, Honeywell claims it sought to reduce its opportunity to benefit from this monopoly by reducing information costs in the aftermarket. [Br. in Opp. 10-11]. These emperor's clothes helped facilely persuade the Sixth Circuit that Honeywell had committed no anticompetitive act to take advantage of its monopoly. *PSI Repair Services*, 104 F.3d. at 820-821.

While Honeywell makes much of its efforts to inform its customers of its policy, any sales information provided by Honeywell has no bearing on antitrust analysis when customers still do not and cannot lifecycle price. Even if customers know the policy in its many facets, they still do not know its price. Without this critical information, competition in the equipment market remains decoupled from market power in the aftermarket. *Kodak*, 504 U.S. at 472. In this case, as in *Kodak*, this lack of knowledge allows Honeywell to take advantage of its control over parts to reap monopoly profits in the aftermarket without substantial impact in the equipment market.

Even assuming that Honeywell's sales efforts significantly mitigated the effect of high information costs, Honeywell fails to address the Sixth Circuit's complete disregard for the economic impact of switching costs. As this Court stated:

> A second factor undermining Kodak's claim that supracompetitive prices in the service market lead to ruinous losses in equipment sales is the cost to current owners of switching to a different product. See Areeda & Turner, at para. 519a. n.23.

Kodak, 504 U.S. at 476. While PSI adduced undisputed evidence of "phenomenal" switching costs (C.A. App. 1351-1352), the Sixth Circuit failed to address their ability to produce a less responsive connection between the primary market and the aftermarket. Honeywell has failed to offer any explanation for the Sixth Circuit's clear failure to consider the impact of switching costs on Honeywell's ability to control price and competition in the aftermarket.

Indeed, even in addressing the conflict among the circuits, Honeywell bypasses any discussion of switching costs, focusing instead on a hunt for any policy changes to support its claim of cohesion among the circuits. In so doing, Honeywell ignores the economic analysis of both the 3rd and the 5th Circuits concerning the effect of switching costs in buffering competition in the equipment market from the aftermarket. In both *United Farmers Agents v. Farmers, Ins. Exchange* and *Allen-Myland v. IBM*, the Courts of Appeals noted that high switching costs alone could prevent competition in the equipment market from disciplining price in the aftermarket. *United Farmers Agents*, 89 F.3d. 223, 239 (5th Cir. 1996); *Allen-Myland*, 33 F.3d 194, 208 (3rd Cir. 1994). Such an analysis was echoed by the Sixth Circuit in *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11

F.3d 660, 667 (6th Cir. 1993)(*"Virtual II"*), *amending* 995 F.2d 1324 (1993). These cases are in line with *Kodak*. The decisions of the First and Seventh Circuits as well as the Sixth Circuit's decision in *PSI Repair Services* are not. See *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756, 763 (7th Cir. 1996) and *Lee v. Life Ins. Co. of North America*, 23 F.3d 14, 20 (1st Cir.), *cert. denied*, 513 U.S. 964 (1994). Contrary to the First, Seventh, and now Sixth Circuits, surprise is but only one economic theory by which a manufacturer may reap supracompetitive prices in the aftermarket without losing significant sales in the equipment market. *Kodak*, 504 U.S. at 476-477. This Court should not let stand the introduction of another crucial "element" to a tying and monopolization claim.

Respectfully submitted,

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